Written Testimony before the
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Chairman Moran and members of the Sub-Committee, I thank you for the opportunity to appear before you today. I am an Agricultural Economist at Mississippi State University and devote a significant portion of my time to researching agricultural risk and policy. As the Federal Crop Insurance Program has expanded and become an increasingly important part of federal farm policy, I appreciate the opportunity to testify today.

Increased Participation and Rating Improvements

Let me begin by pointing out the significant increase in participation in the crop insurance program that has occurred in the last several years. When I began researching crop insurance in 1991, crop insurance participation was around 30 percent where offered and many fewer crops were covered than today. Now we have around 80 percent coverage on many major crops, and many more insurance products exist (Glauber, 2006).

This remarkable program expansion is in large part due to the changes in the program resulting from the crop insurance reform act of 1994 and the ARPA Act of 2000. Certainly, the additional subsidies have induced greater participation which has many policy implications. But I believe we should recognize the profound actuarial implications that have occurred. Some of my research strongly supports the well accepted premise that the program prior to the participation increases was strongly adversely selected (Coble, Knight, and Isik). That is, prior to 1995, the program insured the riskiest producers and low-risk producers opted out of the program even though they may have wanted and needed risk protection.

The problem was that RMA was being asked to correctly rate producers who did not participate and for whom RMA did not have the necessary data. I believe the increased participation along with several actuarial studies commissioned by RMA under the authority of ARPA have made great strides toward much more accurate rates. I also expect to see continued improvement in the next few years as more research is implemented. I readily admit there are problem spots where high levels of catastrophic coverage remain the norm and other problematic issues exist. These issues need to be addressed, but we are clearly moving toward a more actuarially fair program.

The 'Combo' Policy

I also want to note that the forthcoming 'combo policy' should be a significant step toward simplifying the program for farmers, agents, companies, and RMA. The consolidation of the APH and various individual revenue products will eliminate duplicative policies that provide quite similar but not identical coverage. I believe the efficiency gains will be dramatic. Producers will be able to make more informed choices about which products to purchase. Furthermore, it will eliminate the potential for divergent rating systems to call into question program integrity. I believe common sense dictates that programs should not overlap each other to avoid confusion and additional program costs.

Interaction of Risk Management Instruments

Since this committee has oversight of commodity programs and crop insurance, let me also mention a topic often overlooked when discussing crop insurance and commodity programs. Producers also have private risk management tools such as forward contracts, futures and options available. My past research clearly shows that commodity programs such as Loan Deficiency Payments, Counter-Cyclical Payments, crop yield or revenue insurance, and hedging interact with each other (Coble, Miller, Zuniga, and Heifner). When considering the safety net for producers of program crops, commodity programs, crop insurance, and private risk tools such as futures markets are typically used by producers. Ultimately, I would suggest that the government's role is to step in where risk management tools are not available. But in cases where private risk tools such as futures markets are available then the government has less justification for intervention. An example of these choices are decisions that the FCIC must make with respect to livestock price risk management tools where in some cases futures markets exist and in other cases the markets do not exist. However, the lack of futures markets makes rating price risk management tools much more difficult.

AGR and AGR-Lite

Keith Collins, Chair of the Federal Crop Insurance Board of Directors, recently mentioned AGR and AGR-Lite as potentially cost effective products with the ability to cover a variety of diversified crop and livestock farms that do not have a traditional crop insurance product available. I agree with his conclusion and I will also echo his statement that these are actually very complex products. While on the surface AGR and AGR-Lite are conceptually simple, implementation of these relatively new products poses some of the most difficult underwriting and actuarial issues in the RMA portfolio of products. For example, the adjustments to Schedule F accounting are complex, and rates subsuming several enterprises are difficult to accurately assess. I believe RMA has correctly attempted to strike a balance between extreme complexity to avoid abuse and preventing the program from becoming overly burdensome on companies, producers, and agents. I suggest that these programs avoid overlapping with the new 'combo' revenue products and continue to be piloted for further actuarial and underwriting refinements.

Expansion of GRP and GRIP Participation

Recently attention has been given to the rapid expansion of GRP and GRIP. My sense is two reasons are driving this shift. First, some producers have observed declining APH yields and are opting for a product that is based on longer time series. In other regions there is a perceived greater pay-out for the GRP and GRIP products than other products, in part due to price declines causing pay-outs for the GRIP program. I believe that some of this movement will reverse when more normal weather conditions occur and price movements go in the opposite direction. What price and weather variations will be like in the future is extremely difficult to guess. RMA implicitly forecasts losses, as do various agricultural economists, crop insurance agents, and producers at the local level. All make different assumptions and generally get different answers. Ultimately, more than a few years of experience are necessary to evaluate any crop insurance program and that will prove true for this situation as well.

Premium Reduction Plan and Experience-based Discounts

The Premium Reduction Plan has been widely debated and witnesses recently before this sub-committee have presented a number of arguments pertaining to this issue. I have not investigated this issue and will allow others to address the specifics of premium reduction plans. However, recent testimony by Sam Scheef of the American Association of Crop Insurers suggests that performance-based discounts would be a useful alternative to the premium reduction plan. While the two programs differ significantly, I have been involved in an ongoing contractual project funded by RMA which is investigating experience-based discounts. Our preliminary analysis suggests there is potential for Experience-based discounts to reward producers much as 'good driver' discounts operate in automobile insurance. However, several implementation issues are currently being investigated and are not fully resolved.

WTO Implications

Crop insurance has certainly not received the scrutiny other commodity programs have under WTO such as in the recent Brazilian cotton case. However, USDA has chosen to report crop insurance support in the amber box. My understanding is that whole-farm income insurance or income safety nets clearly appear to be WTO-compliant when coverage levels do not exceed 70 percent of expectations (Schnepf). However, when revenue designs go beyond this specific form, WTO status is less clear. For example, whether commodity-specific programs would meet this criterion is questionable.

References

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